

CALIFORNIA DEPARTMENT OF FOOD AND AGRICULTURE
AUDIT OFFICE



MILK POOLING BRANCH
MILK POOLING EQUALIZATION FUND

AUDIT REPORT
#09-073

FISCAL YEAR ENDED JUNE 30, 2008

CALIFORNIA DEPARTMENT OF
FOOD AND AGRICULTURE

DIVISION OF MARKETING SERVICES
MILK POOLING BRANCH

MILK POOLING EQUALIZATION FUND

AUDIT STAFF

Ron Shackelford, CPA
Shakil Anwar, CPA
Tommy Torres, CPA

Audit Chief
Assistant Audit Chief
Audit Manager

REPORT NUMBER
09-073

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EXECUTIVE SUMMARY

In compliance with Section 62712(c) of the Food and Agricultural Code mandating an annual audit, we have audited the financial operation of the Milk Pooling Equalization Fund (MPEF). The audit covers the fiscal year ended June 30, 2008.

The objectives of the examination were to evaluate the internal control structure of the financial operation of the Milk Pooling Equalization Fund and to obtain reasonable assurance about whether the financial records are free of material misstatement.

RESULTS OF EXAMINATION

The examination findings were discussed with Mr. Donald Shippelhouse, Senior Agricultural Economist Supervisor, and Mr. John Lee, Branch Chief, for the Milk Pooling Branch (MPB) as items were discovered.

During our review of the internal control structure and compliance with State laws and regulations, we identified one area containing a reportable condition. The reportable condition is considered a weakness in the operation of internal controls over the Milk Pooling Equalization Fund. We have provided two recommendations to improve the operations of the fund. The MPB must respond in writing on how each recommendation will be implemented.

INTRODUCTION

The California Department of Food and Agriculture (CDFA), Milk Pooling Branch (MPB) administers the MPEF in accordance with the Food and Agricultural Code, Division 21, Part 3, Chapter 3. The MPB is responsible for administering the Pooling Plan for fluid milk, which, together with the Dairy Marketing Branch (DMB), promotes, fosters, and encourages the intelligent production and orderly marketing of milk. Separation of duties exists in the Department for proper safeguarding of the fund. The DMB is responsible for the collection of delinquent equalization funds and assessments by handlers and the Financial Services Branch is responsible for cash receipts, deposits, cash disbursements, bank reconciliation, and maintaining the general ledger.

CONCLUSION

Except for the findings described in this report, the Milk Pooling Branch and the Financial Services Branch have maintained adequate internal controls over the operation and administration of the Milk Pooling Equalization Fund. Furthermore, the financial reports reviewed were accurate in all material respects with any variances reconciled and eventually adjusted at some future date.

REPORTABLE CONDITIONS

COLLECTION OF DELINQUENT HANDLER PAYMENTS

A review of the MPEF's outstanding accounts receivable balances disclosed that two handlers have never remitted handler fees and have been delinquent since early 2002 and 2005, respectively. Through July 31, 2008, the total outstanding balances owed by the delinquent handlers have increased to \$591,593 and \$119,652, respectively. Exhaustive collection efforts have included telephone calls, letters, administrative actions, a settlement conference, and finally, multiple legal actions initiated by the branch.

The MPB obtained a judgment against the first handler, after which the handler subsequently filed a notice of appeal. This handler participated in the Market Milk Pooling Plan while the delinquent balance continued to accelerate, until January 12, 2004, when the handler was declared ineligible for coverage under the Milk Producers Security Trust Fund. The MPB is working on a payment agreement with the first handler since the petition for review was denied by the Supreme Court and the court's judgment in favor of MPB still stands. The court has set the case management conference for a mandatory settlement conference and trial readiness in July 2010. The court also set a trial date of August 2, 2010. This was a prior year audit finding.

In addition, CDFA served the second handler with a complaint in February 2007. Currently, the department is waiting for a court date to resolve this matter. However, it should be noted that the second handler no longer exists as a cooperative. The California Attorney General's office has been engaged to find any monies/assets that this handler would have available to cover this liability. This was a prior year audit finding.

The Food and Agricultural Code, Division 21, Part 3, Chapter 2.5 defines the Milk Producers Security Trust Fund. Article 9, section 62640 states "If a handler defaults in payments to the pool equalization fund provided for in Chapter 3 and the director determines that additional efforts will not result in collection of the amount due, the director, after consultation with the board, may pay money from the Milk Producers Security Trust Fund to the pool equalization fund to cover the amount of the default."

Article 11, Section 1100 of the Market Milk Pooling Plan requires a pool manager to act for the Secretary, to the extent authorized by the Secretary, under the law in effectuating the terms and provisions of this Plan and shall perform any or all the

duties authorized by the Secretary in the administration of this Plan. Such duties shall include, but are not limited to, the following:

- a. Maintain records and reports that accurately reflect the operation of the Plan, including the receipt and disbursement of all monies handled;
- b. Verify all reports and payments by each handler subject to the provisions of this Plan through audit of the books, records, and accounts of such handler, and the examination of operations or other verification deemed relevant;
- c. At the pool manager's discretion, publicly announce the name of any handler who has not made payment as required pursuant to Sections 1001, 1003, and 1005. Any handler may be excluded from the computations in determining quota and base prices if this should become necessary due to the handler's failure to comply with the payment provision specified in this paragraph.

Recommendations

1. *The MPB should continue their collection efforts for these two delinquent handlers. Furthermore, the MPB should continue to explore and perform any other collection procedures deemed relevant as required in the administration of the Plan. The MPB should estimate a timeline as to when they deem enactment of section 62640 might be appropriate.*
2. *To ensure similar situations do not occur in the future, the MPB should review and evaluate their current policies and procedures for delinquent assessment collection. The MPB should explore requiring performance bonds, escrow deposits, or other improvements to ensure that the procedures are timely, effective, and relevant, as required by good business practices and the safeguarding of accounts receivable.*

MILK POOLING BRANCH'S RESPONSE



CALIFORNIA DEPARTMENT OF
FOOD & AGRICULTURE

A. G. Kawamura, Secretary

November 12, 2009

Mr. Ron Shackelford, Chief
Audit Office
California Department of Food & Agriculture
1220 N Street, Rm. 344

Dear Mr. Shackelford,

This letter is to respond to the letter from the CDFA Audit Office dated October 14, 2009. The letter was regarding the results of the audit of financial records for the Milk Pooling Branch for the fiscal period July 1, 2007 through June 30, 2008.

The two reportable conditions that were identified in the report involved unpaid liabilities by handlers for pool obligations due the Milk Pooling Equalization Fund. Using the authority given to the Department by the California Food and Agricultural Code and California Milk Pooling Plan, we had implemented our procedures to collect these non-payments.

Both of these incidences have been referred to the Attorney General's Office and in the case of Organic pastures, the petition for review was denied by the California Supreme Court and the court's judgment in favor of Milk Pooling Branch remains. As noted, the next phase to collect monies for pool obligation and assessments has begun and the Superior Court in Fresno County has set the case management conference for a mandatory settlement conference and trial readiness in July 2010. The court also has set a trial date of August 2, 2010. We will continue to work with the Attorney General's office to prepare for the upcoming settlement conference and trial.

The other situation, Central Valley Dairymen (CVD), continues to be monitored by the Attorney's General's Office for our interests. We do not anticipate an accelerated conclusion to our claim. Kathleen Meehan, of the AG's office, has been in contact with us and we will keep in contact with the AG's office as to the activities involved in their attempts to obtain payment. We also anticipate to consult with the Milk Producers Security Trust Fund Board to implement Sec. 62640 of the California Food and Agricultural Code to pay monies out of the Trust Fund to cover the CVD default on Pool Obligations.

As mentioned in the August 15, 2008 audit letter, we have in place monthly procedures that address non-payment of pool obligations and assessments by handlers. When non-payments are found we have procedures in place beginning with follow-up letter leading to additional action including putting the offending handler on the Ineligible list for coverage of producers by the Milk Producers Security



Mr. Shackelford
November 12, 2009
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Trust Fund (MPSTF) and require a greater bond amount. If that is not successful to induce payment we can begin the process to revoke their handler's license via an administrative hearing.

Since the last audit letter, we met with our stakeholders to discuss requirements for progressive enforcement action on handlers who have a record of being delinquent on their pool obligation and assessments. Our stakeholders have recommended the Milk Pooling Branch continue their efforts and if necessary increase bonds or acceptable securities; initiate and continue referrals to the Attorney General's office and Local District Attorney's office when necessary. In addition, we will continue to update our stakeholders on our efforts to obtain payments.

Sincerely,

A handwritten signature in cursive script, appearing to read "John Lee".

John Lee, Chief
Milk Pooling Branch

cc: Kevin Masuhara, Director
Division of Marketing Services

Don Shippelhoue, Sr. Agricultural Economist
Milk Pooling Branch

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CDEA EVALUATION OF RESPONSE

A draft copy of this report was forwarded to the management of the Milk Pooling Branch, for their review and response. We have reviewed the response and it satisfactorily addresses the findings contained in this report.

DISPOSITION OF EXAMINATION RESULTS

The findings in this management report are based on fieldwork that my staff performed during June, 2009, July 2009 August 2009 with completion by October 1, 2009. My staff met with management on October 1, 2009 to discuss the findings and recommendations, as well as other issues.

If you have any questions, please contact the Audit Office at (916) 322-3300.



Ron Shackelford, CPA
Chief, Audit Office

October 1, 2009

REPORT DISTRIBUTION

<u>Number</u>	<u>Recipient</u>
1	Director, CDFA Division of Marketing Services
1	Chief, Milk Pooling Branch
1	Accounting Administrator, CDFA Financial Services
1	Chief Counsel, CDFA Legal Office
1	Audit Chief, Audit Office